Member Business Lending

Regulators' Perspective

Webinar Hosted by NCUA Board Member Gigi Hyland
November 18, 2009

Frequently Asked Questions

Organized By Subject Area:

(Click below to jump to that section)

Staffing & Department Structure

1. What is the minimum asset size a credit union should be to have an MBL Vice President, Development Officer, Analyst and an Administrator?

   The structure of an MBL department depends on the asset size of the credit union, quantity and size of the portfolio, and the complexity of the business loans. However, there is no definitive size in order to have different MBL personnel. The individual responsible for consumer lending portfolio should not be managing the commercial loan portfolio since business lending requires specific knowledge and expertise which consumer lending personnel would not typically possess. In addition, the individual who approves the loan should not be the one who processes and underwrites the loan.

2. Do you think the current aggregate MBL limits are keeping credit unions from fully staffing their MBL departments (i.e. they can't make enough loans to justify the staff under the current 12.25% cap)?

   Each credit union's staffing level should be commensurate with the size of the MBL portfolio and the complexity of the loans granted. The credit union's asset size and net worth would usually determine the maximum size of the MBL portfolio. For example the MBL portfolio for a credit union with an asset size of $10 billion would allow for and require larger MBL staff to manage the portfolio than a credit union with an asset size of $10 million. However, for credit unions that want to get involved in MBLs but cannot justify the cost of a fully staffed MBL department, there are alternatives available such as using third party consultants and CUSOs, partnering with another credit union, or getting involved in loan participations.

3. Can a relationship manager develop the business and perform the credit write up and present it to management for review?

   Yes, if the relationship manager has the minimum required underwriting expertise to properly analyze the loan and present it to management for approval.

4. Is there a specific requirement to have a Loan Committee?

   No. There is no specific requirement for a loan committee. It would depend on what was approved by the credit union board in the credit union's bylaws. The credit union needs to ensure that there is a suitable lending approval structure in place for the type, size, and volume of loans provided to the membership.

Back to Top

Experience Requirements

5. How many years experience do we need? How specialized is the 2 year experience requirement? This is the most difficult issue with credit unions. Can an experienced commercial lender who historically made residential rental property loans sufficiently qualified to underwrite a strip mall loan (commercial retail rental) space as well?

   NCUA Rules and Regulations Part 723 requires minimum of 2 years experience. NCUA Opinion Letter 08-0128 provides additional clarification noting that individuals who meet the requirement must have lending experience directly related to the type of MBLs the credit union intends to offer. These individuals must be familiar with the proper underwriting, analysis, and origination of loans of a particular type in order to understand their complexity and risk exposure. For example, someone who only has experience with financing residential real estate for homebuilders probably does not have sufficient lending experience for commercial land development and construction, or purchase of a commercial strip mall.

6. Where can you find advanced MBL training for lenders and underwriters, especially for underwriting large credits (in the millions)?

   Various trade organizations such as credit union leagues and credit union service organizations (CUSOs) specializing in member business lending may offer training. In addition, you may want to contact other credit unions that may be able to provide assistance in finding appropriate training.

7. If we have used a CUSO to perform underwriting in the past and we feel that we have developed sufficient expertise internally to underwrite smaller loans $100,000 or less, what will the examiner require from the CU to support the decision for underwriting the loans internally?

   If the credit union used the services of a CUSO to underwrite in the past, reviewing these loans that were underwritten by a CUSO is not considered adequate training for actual underwriting experience. Internal staff could be trained by the third party vendor by having experienced third party underwriters review the work of the internal credit union underwriter until that individual gains the required experience. Management would have to document how the internal staff actually gained the hands-on experience to underwrite in order to show sufficient expertise in that area.

8. If an underwriter has to have a vast expertise in a specific type of loan, how can an examiner come into a credit union and critique a loan without any commercial lending experience?

   NCUA has examiners with prior commercial lending experience. In addition, there are examiners that are Specialized Lending Subject Matter Experts with extensive training and experience in reviewing different types of loans including various commercial loans. They are available to provide assistance to examiners during examinations of MBLs. Training is also available to all examiners on commercial lending through Specialized Lending conferences, regional training, and Federal Financial Institution Examination Council Examiner Education Office.

Back to Top

Risk Rating System

9. Please repeat the ratios of materiality that determine whether or not the CU needs to establish the risk ratings.

   The Washington State Division of Credit Unions defines materiality for risk rating purposes as credit unions that have over five percent in aggregate MBLs to total assets or over $25 million in MBLs. NCUA does not have any specific requirement for risk ratings but encourages credit unions to develop an appropriate risk rating system as a safe and sound business practice.

10. Do you assign risk by the loan or by the relationship?

   Management will need to decide if relationship lending is in the best interest of the credit union. A risk rating may be assigned to the relationship with that risk rating

[Back to Top](#)

utilized as the basis for loan pricing. In that case, it is also necessary to underwrite individual loans to the relationship and assign appropriate risk ratings to the individual loans as well as the relationship.

11. In regards to a Risk Rating System, what do regulators require, if anything, for MBLs purchased through participations with other credit unions?

    For MBLs purchased through a participation agreement, it would be a sound business practice for the purchasing credit union to assign a risk rating for each purchased loan based on the purchasing credit union's own internal risk rating system. The purchasing credit union should not rely solely on the risk rating of the originating credit union.

12. Due to the importance of having an effective risk rating system, would NCUA consider developing a framework that credit unions can use to implement a risk rating system for each MBL loan type when looking at concentration risks by borrower or group of borrowers? In addition, what criteria do regulators use to determine the concentration risk?

    A risk rating framework provided by NCUA would be extremely restrictive and burdensome for credit unions to implement. Such a risk rating framework could not adequately factor in all of the characteristics that make up various loan types and take into consideration the unique qualities used by credit unions in developing the risk threshold and tolerances. One risk rating framework cannot work for all credit unions and all loan types. There are various effective risk rating systems that work for different credit unions. Credit unions should develop an appropriate risk rating system that works best for the type of loans that management is engaged in.

13. When doing a MBL review and finding a loan that has its risk rating downgraded, even though a payment has never been missed, what action if any should be taken other than placing it on a watch list?

    A key factor in determining what additional action is necessary depends on the reason for the downgrade. If the downgrade was based solely on declining real estate collateral value with no other negative changes in the borrower's financial condition, no action may be required. Continued close monitoring of the situation may be adequate in this case. However, if the downgrade was due to the deterioration in the borrower's financial condition although loan payments remained current, management may need to take additional action. The credit union needs to assess the potential for eventual default and develop a workout plan to minimize the potential for loss. The FFIEC policy statement dated October 30, 2009, on Prudent Commercial Real Estate Loan Workouts discusses this situation and can be found on NCUA's website: http://www.ncua.gov/news/press_releases/2009/FFIEC_PR_CRE_Workouts_10-30am.pdf.

Back to Top

Loan Reviews

14. At what dollar amount should we review annually? How often do you recommend performing periodic reviews? Is a periodic review every two years adequate? Can you address issues with obtaining annual financial statements to complete annual reviews?

    There is no minimum dollar amount to determine the frequency of the periodic review. However, you should review each loan at least annually, with certain loans being reviewed more frequently (i.e. weekly, monthly, quarterly), such as more risky types of loans (e.g. accounts receivable, inventory, floor plan), loans that are delinquent or on a watch list, and large loans. The frequency and type of information borrowers are required to submit to the credit union must be documented in the loan documents. Failure by the borrowers to submit timely information is typically documented as a condition of default. Credit unions should regularly review the borrowers and guarantors' financial condition, credit rating/score, collateral condition and value, status of the loan covenants, etc.

15. Does the examiner also review the closing documentation to ensure the loan that closed is the one that was approved?

    Yes. Examiners may review the final documents to ensure that the information is consistent with the loan which was approved. Any discrepancy should be documented clearly in the loan file with appropriate approval.

16. What is the NCUA examiners policy on using unaudited financial statements from small business borrowers?

    Prudent underwriting requires the credit union to assess the reliability of internally prepared financial statements. A credit union's policy should define the type of financial statements required, i.e. internally prepared, CPA compiled, reviewed or audited. This is most often determined by the borrower's asset size or annual sales revenue.

Back to Top

Guarantor

17. Reference a personal guarantee as it relates to RegFlex, if the credit union meets the criteria for RegFlex as laid out in the regulations, is additional approval required from the regulatory body?

    No. If the credit union meets the criteria for RegFlex, no additional approval is needed related to a personal guarantee. However, management should determine whether not obtaining a personal guarantee is a sound business practice for the type of loans granted.

18. Is there a minimum consideration requirement (stake) for a guarantor in order for the CU to pursue a guarantor legally for collection/repayment of the loan?

    There are numerous types of guarantees. A guarantee may be limited or unlimited. A guarantee could be continuing or have a set expiration date. In cases where multiple entities guarantee the same loan, the guarantees may be "joint and several" or a defined order may exist. The most desirable guarantee type must be determined during the underwriting process. Depending upon the complexity of the transaction, it may be advisable to have the loan documents drafted by an attorney to ensure the desired terms are appropriately documented.

Back to Top

Appraisal

19. If you have a small MBL department, what do you recommend the CU do in terms of having the appraisal report reviewed by someone not involved in the lending process (underwriting & approval)?

    Prior to a final credit decision, credit unions should perform a compliance review on all appraisals to confirm that they comply with the minimum appraisal standards as outlined in the NCUA Rules and Regulations Part 722. Loan files should document this compliance review, which may be in checklist or narrative format. In addition, certain appraisals should be reviewed more comprehensively to assess the technical quality of the appraiser's analysis prior to making a final credit decision. Credit unions should establish guidelines for a more detailed, technical review based on transaction risk, transaction size, or other criteria. The review can be performed by a third party or someone at the credit union. However, the individual who reviews appraisals should be independent of the transaction and possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction.

20. 722.3 states an appraisal is not required if the loan value is below $250,000. Does that rule apply to refinancing existing MBLs that have ballooned and would like to renew?

    Yes. Although an appraisal may not be required, it may be a sound lending practice to perform an appraisal, especially in light of declining property value. Credit unions should have a policy that addresses appropriate methods to accurately determine the value of the collateral to ensure compliance with the maximum loan to value requirement.

Back to Top

Allowance for Loan Losses/Delinquency

21. Do you have any published guidance on the Allowance for Loan Loss?

    Yes. Letter to Credit Unions 02-CU-09, on Allowance for Loan and Lease Losses (ALLL) and Interpretative Ruling and Policy Statement (IRPS) No. 02-3. The letter clarifies NCUA's expectations regarding methodologies and documentation to support the ALLL. The guidance recognizes that credit unions should adopt methodologies and documentation practices that are appropriate for their size and complexity.

22. Do you recommend setting aside a loan loss reserve for every loan regardless of risk rating or do you feel loss reserve should only be taken when a transaction begins to deteriorate?

    You should consult your CPA to determine appropriate ALLL funding in accordance with Generally Accepted Accounting Principles. You can also review the Letter to Credit Unions 02-CU-09, on Allowance for Loan and Lease Losses and Interpretative Ruling and Policy Statement (IRPS) No. 02-3. Further, the FFIEC policy statement dated October 30, 2009, on Prudent Commercial Real Estate Loan Workouts also provides helpful information on this matter. The policy statement can be found at: http://www.ffiec.gov/guidance/cre103009.pdf.

23. We have a commercial loan that has ballooned after 3 years. The loan was originally done at 75% loan to value. The members made all payments as agreed and maintained above average business income/debt ratios. Unfortunately, the commercial values in our market decreased dramatically over the last couple years. Our members now have a MBL at 95% LTV. They have no extra cash, assets of value, or additional equity on their personal residence. What can be done to help these members who have paid more than agreed and operate a profitable business?

    The FFIEC policy statement on Prudent Commercial Real Estate Loan Workouts discusses this situation. Many borrowers whose loans mature in the midst of an economic crisis have difficulty obtaining short-term financing or adequate sources of long-term credit due to deterioration in collateral values despite their current ability to service the debt. In such cases, credit unions may determine that the most appropriate and prudent course is to restructure or renew loans to existing borrowers who have demonstrated an ability to pay their debts, but who may not be in a position, at the time of the loan's maturity, to obtain long-term financing. Examiners recognize that prudent loan workout agreements or restructurings are generally in the best interest of both the credit union and the borrower.

24. Can Method D for delinquency calculation be used on MBLs if the maturity is under 15 years?

Prior to September 1981, the NCUA Accounting Manual contained an additional delinquency calculation method known as Method D. This method does not consider the "time value of money", and as a result, often understates loan delinquency. Under Method D, a member can miss several payments on a loan and then make a lump sum "catch-up" payment that totals the sum of the missed payments and not be considered delinquent. Under other delinquency calculation methods that consider the "time value of money", the member would be considered delinquent until a catch-up payment was made that included the related accrued interest. NCUA does not require a credit union to use a particular loan delinquency calculation method. Management must calculate loan delinquency consistent with loan contract terms, which can vary widely.

Back to Top

Loan Participation

25. Are loan participations better to start with than getting directly into commercial lending?

Loan participations are not better or worse than starting a commercial lending program. It depends on a credit union's strategic objectives and goals, resources available to manage the commercial lending program, risk assessment, etc. Management should perform a comprehensive assessment of the benefits and the risks of entering a loan participation program versus starting a commercial lending program prior to making the decision.

26. What is the additional risk with participations for the purchasing CU (i.e., very limited control over the credit)?

Letter to Credit Unions 08-CU-26 on Evaluating Loan Participation Programs addresses the various risks associated with the program. A purchasing credit union would be exposed to credit, interest rate, liquidity, transaction, compliance, strategic, and reputation risks.

27. Are credit unions permitted to purchase/participate with non-member (i.e., bank customer) loans?

Yes, but only if the borrower is a member of a credit union that is participating on the loan. NCUA Rules and Regulations Part 701.22(d) lists several requirements which include limiting credit unions to participating in loans only if made to their own members or members of another participating credit union.

28. Can you discuss differences in expertise, outsourcing, and examination issues for participations versus CU originated MBLs?

    NCUA Rules and Regulation Part 701.22(d)(1) states that a credit union can only purchase participations in loans it is empowered to grant. A credit union must review the underwriting and base its decision to purchase a participation in the same manner as a commercial loan originated in-house.

Back to Top

CUSO/Third Party Relationships

29. If you are starting a new MBL program, is it advisable to work with a CUSO or just start a new program in-house?

    Management must make this decision based on the credit union's strategic goals and risk tolerance. A credit union should perform proper risk assessment prior to making this decision, and due diligence prior to engaging in the third party relationships.

30. Regarding third party relationships, if a neighboring credit union uses a CUSO, is it alright for our credit union to use that CUSO too, without doing a full-blown due diligence process?

    No. Each credit union should perform its own risk assessment to determine the credit union's needs and risk tolerance and perform a complete due diligence review on the potential CUSO to ensure they can meet your needs.

31. How important is it for the credit union's management to understand a specific "industry" when utilizing a third party (i.e., CUSO) to underwrite commercial loans?

    Management must have sufficient knowledge of the specific industry to be able to assess the work of its third party vendor. At a minimum, management must be capable of asking the right questions before approving a commercial loan.

32. How do we evaluate a third party CUSO?

    Letter to Credit Unions 07-CU-13 on third party due diligence and the related AIRES questionnaire provides valuable information on evaluating third party relationships. Credit unions should maintain adequate documentation to understand the third party's organization, business model, financial health, and program risks. In addition, management should also demonstrate knowledge of all the processes involved with prospective third party program and understand a prospective third party's responsibilities.

33. If we use a CUSO for underwriting and it recommends not making the business loan, what documentation do we need if we decide to make the loan anyway?

    Management must fully document the approval process for all commercial loans approved. Ultimately, the loan approval is the credit union's responsibility. However, if the credit union decides against the recommendation made by the underwriter and grants the loan, the rationale for the loan approval should be documented in the loan file, and/or the Loan Committee minutes. The credit union should also address in the policy or procedures the proper reporting mechanism to ensure that the board or upper management is aware of these types of situations.

34. If the CU uses a third party for underwriting, will the examiner review or interview the third party?

    Yes. NCUA examiners may interview the third party and/or review their documents to obtain a better understanding of the underwriting procedures and practices.

Back to Top

Small Business Administration (SBA) Loans

35. Does NCUA encourage credit unions to utilize the Small Business Administration's (SBA) loan programs which offer a 90% guarantee under its primary loan program?

    a. NCUA encourages participation in the various programs sponsored by the SBA if it fits into the credit union's strategic goals. Each credit union needs to make its own determination based on expertise available and the acceptable risk tolerance level. In the past, NCUA conducted a webinar on SBA lending that can be found on NCUA's website: (http://www.ncua.gov/GenInfo/Members/Hyland/Presentations/SBA2006/lobby.html).

    In addition, NCUA amended the collateral and security requirements of the member business loan rule to enable credit unions to participate more fully in Small Business Administration (SBA) guaranteed loan programs. See also: Federal Register Vol 69, No 207 – NCUA 12 CFR Part 723 Member Business Loans – Dated Wednesday October 27, 2004; NCUA General Counsel Opinion Letter 08-1109 – Applicability of Certain Regulatory Requirements for SBA Loans -12/18/2008; PDF or MS Word available at http://www.ncua.gov/Resources/RegulationsOpinionsLaws/OpinionLetters/2008.aspx.

36. Are SBA guaranteed participation loans common for credit unions?

    SBA loans are usually not a common type of loan participation. SBA loans currently only represent a small portion of total business loans being reported by federally insured credit unions. As of June 30, 2009, SBA loans only make up 5 percent of the total number of business loans (7,360 out of 136,521). As SBA lending grows, SBA loan participations may become more common.

37. Given that the SBA defines "business loans" as those loans >= to $50,000 (if I am not mistaken), if our credit union wants to make an MBL to a business for $35,000 to purchase a commercial truck, is it acceptable to book that loan and make that loan as a business loan in spite of the loan amount of $35,000? Or is there a better way to handle this loan as a business loan?

    NCUA's definition of member business loan is for regulatory reporting purposes. A business loan under $50,000 is still a business loan but would not count towards calculating the various regulatory limits. A credit union should underwrite all business purpose loans in a prudent manner regardless of whether the loans must be reported as member business loans in the call report by regulation.

38. SBA has included in some of their loans a prepayment penalty. This is in violation of NCUA Rules and Regulations. Will an exception be allowed for on these SBA loans or will it be required that SBA remove the prepayment penalty?

    Legal Opinion 03-911 dated May 20, 2004, notes that while a federal credit union generally cannot charge a prepayment penalty on a loan, it can if it is part of a government guaranteed or insured loan program such as SBA loans. In addition, federally insured state chartered credit unions may be able to charge a prepayment penalty if it is allowed by the state supervisory agency.

Back to Top

MBL Regulatory Limits

39. Is the NCUA approving applications for MBL cap waivers at this time? What factors does the NCUA consider when granting a waiver on the limit on business loans to a single entity (15% of net worth)?

    NCUA will review request for waiver of certain MBL regulations listed in the NCUA Rules and Regulations such as:

    (a) Appraisal requirements under §722.3;
    (b) Aggregate construction and development loans limits under §723.3(a);
    (c) Minimum borrower equity requirements for construction and development loans under §723.3(b);
    (d) Loan-to-value ratio requirements for business loans under §723.7(a);
    (e) Requirement for personal liability and guarantee under §723.7(b);
    (f) Maximum unsecured business loans to one member or group of associated members under §723.7(c)(2);
    (g) Maximum aggregate unsecured member business loan limit under §723.7(c)(3); and,

(h) Maximum aggregate net member business loan balance to any one member or group of associated members under §723.8.

To request a waiver, a federal credit union must submit a request to the Regional Director and a federally insured state chartered credit union must submit a request to the state supervisory authority. Once the credit union provides all the required documents listed in Rules and Regulation Part 723.11, NCUA will review the complete application to ensure there are no safety and soundness concerns related to granting the waiver.

40. What is the procedure for a credit union applying for a waiver of the 12.25% limitation?

There is no waiver available for aggregate member business loan limit, which is the lesser of 1.75 times net worth or 12.25 percent of total assets. However, credit unions can obtain an exemption from this requirement if one of the following conditions exists:

(a) Low-income designation or participate in the Community Development Financial Institutions program;
(b) Chartered for the purpose of making member business loans;
(c) History of primarily making member business loans.

To obtain the exemption, a federal credit union must submit documentation to the Regional Director demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state supervisory authority.

41. The cap limit of 12.25% of total assets currently would include those assets classified as other assets. Would OREOs be excluded from the other assets classification?

Other Real Estate Owned (OREO) is not a loan, but an asset acquired by the credit union in the liquidation of loan for which the related loan obligation of the borrower has been canceled. So the OREO would not be included in calculating the MBL aggregate cap limit since it is not a loan.

Back to Top

Compliance

42. Is Commercial Real Estate for residential purposes subject to Home Mortgage Disclosure Act Loan Application Registers (HMDA-LARs) reporting?

HMDA applies to loans for home purchase, home improvement or home mortgage refinance. Under NCUA Rules and Regulations, a loan to purchase, refinance or improve the member's home is not a member business loan. Therefore, member business loans are not subject to HMDA reporting.

43. Does the standard "Anyone may apply" hold true for MBLs as it does with regular loans in a credit union? It seems a lot of work will be required on the credit union side and if this is opened up to any business, this process could be very time consuming and may not result in a positive end.

    No. Credit unions do not have to offer all types of MBLs. In fact, it would be prudent for management to restrict the MBLs to the area where the credit union has the expertise in underwriting and managing. For example, management may decide that it does not want to offer restaurant loans, but may only offer apartment loans or decide to offer loans within a 50 miles radius from the credit union. Credit unions still need to comply with Regulation B, Equal Credit Opportunity, which makes it unlawful to discriminate on certain prohibited basis. The credit union’s policies and procedures should address the trade area and type of loans offered to ensure management does not discriminate on a prohibited basis.

44. Less complex credit unions sometimes use their standard consumer loan docs (i.e. Truth in Lending disclosures, etc) in the documentation of real estate-based MBLs (i.e. income properties). What are your thoughts on this?

    Regulation Z (Truth in Lending) does not apply to business purpose loans. If a credit union chooses to utilize standardized consumer forms to document member business loans, the credit union should consult with the vendor that provided the form to ensure proper usage of the forms. Management should also consult with the credit union’s attorney to ensure that the consumer loan documentations would afford the credit union with the legal right to the collateral and the right to enforce the contract if the loan defaults.

Back to Top

Miscellaneous

45. Can or have small credit unions been successful at running an MBL program?

    Yes. A credit union of any asset size can run a successful member business lending program. Proper planning and prudent management of the program will be the key factors to the program’s success. Small credit unions must set reasonable goals and limits.

46. What do you consider reasonable growth to not outpace risk?

    Reasonable growth depends on the credit union and the type of business loans being offered. When entering into any new program or offering new type of loans, credit unions should plan for a steady growth to allow the loans to season. This ensures that the type of lending fits into the strategic goals and management is able to appropriately service the loans through the various loan cycles and economic conditions. It is important that a credit union develop a strategic plan which addresses the future of the member business lending program whether it is to grow the existing program, enter into a new program, or downsize the current portfolio.

47. What is an AIRES Questionnaire and where can we find one?

NCUA examiners use Automated Integrated Regulatory Examination Software (AIRES) to complete examinations. AIRES Questionnaires are an examination tool available on NCUA website at: http://www.ncua.gov/Resources/CreditUnionResources/aries/index.aspx. There are different questionnaires related to various operational areas.

48. What is a loan covenant?

Loan covenants are clauses in a contract that impose conditions that must be complied with by the borrowers in order to adhere to the terms in the loan agreement. Loan covenants are often utilized to ensure the business is operating in manner that protects the cash flow needed to repay the loan and the collateral. If the borrowers do not act, or refrain from acting, in accordance with the covenants, the loan may be considered in default and the lender may have the right to demand payment. There are many different types of loan covenants that a credit union can impose on MBLs, but many fall under the three categories of affirmative covenants, negative covenants, and financial covenants.

49. What is the recourse for a credit union that feels that some of the comments made during an examination are unfair and biased simply because the examiner does not have enough knowledge about business lending?

If the credit union has any issues, concerns, or problem with the examination report, management may contact the Supervisory Examiner or the Regional Office, or request a formal review by writing to the Regional Director within 30 days of receiving your final report. If you are dissatisfied with the Regional Director’s response and your report meets the criteria of Interpretive Ruling and Policy Statement 95-1, you may appeal to NCUA’s Supervisory Review Committee. The credit union’s appeal must be filed within 30 days of the Regional Director’s response (or within 60 days if your request for review receives no response).

Back to Top